Case No. 114496

IN THE SUPREME COURT OF THE STATE OF ILLINOIS

PERFORMANCE MARKETING ASSOCIATION, INC.,	)	On Direct Appeal to the Supreme Court of Illinois from the Circuit Court of Cook County, County Department, Law Division.
Plaintiff-Appellee,	)	
vs.	)	No. 2011 CH 26333 (Transferred to Law Division)
BRIAN A. HAMER, in his capacity as DIRECTOR, ILLINOIS DEPARTMENT OF REVENUE,	)	The Honorable ROBERT LOPEZ CEPERO, Judge Presiding.
Defendant-Appellant.	)	

BRIEF OF *AMICUS CURIAE* MULTISTATE TAX COMMISSION

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I. INTEREST OF THE *AMICUS CURIAE*

Amicus curiae Multistate Tax Commission ("the Commission") submits this brief in support of the Defendant-Appellant, Brian Hamer, Director of the Illinois Department of Revenue ("the Department"), in this appeal from the determination of the Circuit Court of Cook County, County Law Division, Tax and Miscellaneous Section. The circuit court found that Illinois Public Act 96-1544, codified at 35 ILCS 105/2, (a) impermissibly discriminates against interstate commerce in violation of the Commerce Clause of the U.S. Constitution, Article III, Section 8, cl. 3, and (b) violates the federal Internet Tax Freedom Act's preemption of certain state taxes, 47 U.S.C.A. § 151 (note).[1] The Commission believes that the circuit court decision was erroneous and urges this court to reverse the lower court for the reasons set forth below.

The Commission is the administrative agency for the Multistate Tax Compact ("Compact"), which became effective in 1967. *See* RIA *All States Tax Guide*, ¶ 701 *et seq*. (RIA 2005).[2] Today, forty-seven states and the District of Columbia are members of the Commission. Nineteen states (including the District of Columbia) have legislatively established full membership. Six additional states are sovereignty members and twenty-three are associate members.[3]

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[1] Order dated 5/7/12, *Common Law Record*, Volume 5, pages 1065-67 ("V. 5, C 1065-67").

[2] The validity of the Compact was upheld in *United States Steel Corp.* v. *Multistate Tax Commission*, 434 U.S. 452 (1978).

[3] This brief is filed by the Commission, and not on behalf of any particular member state, except Illinois. Compact Members are: Alabama, Alaska, Arkansas, Colorado, District of Columbia, Hawaii, Idaho, Kansas, Michigan, Minnesota, Missouri, Montana, New Mexico, North Dakota, Oregon, South Dakota, Texas, Utah and Washington. Sovereignty Members: Georgia, Kentucky, Louisiana, New Jersey, South Carolina, and West Virginia. Associate Members: Arizona, California, Connecticut, Florida, Illinois, Iowa,

The purposes of the Compact are: (1) facilitation of proper determination of state and local tax liability of multistate taxpayers, including equitable apportionment of tax bases and settlement of apportionment disputes; (2) promotion of uniformity or compatibility in significant components of tax systems; (3) facilitation of taxpayer convenience and compliance in the filing of tax returns and in other phases of tax administration; and (4) avoiding duplicative taxation. *See* Compact, Art. I.

The importance the Commission attaches to the present case, and our motivation for filing this brief, lies in the goal of facilitating the proper determination of state and local tax liability of multistate taxpayers and in protecting the states' sovereign authority to implement their tax systems in accordance with the principles of federalism that are at the core of the Constitution.

The circuit court's decision, if allowed to stand, would disrupt the states' ability to impose sales and use tax collection obligations on a class of retailers who use affiliates operating in the state to solicit business for them, giving these out-of-state sellers an unfair and unwarranted tax advantage over other in-state and out-of-state retailers. Currently, nine states have "representational nexus" statutes similar to Public Act 96-1544, which defines a retailer subject to sales and use tax obligations to include a seller using a representative in the state to solicit sales on a commission basis, including "internet" solicitation. The Commission itself is developing a model "representational

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Indiana, Maine, Massachusetts, Maryland, Mississippi, Nebraska, New Hampshire, New York, North Carolina, Ohio, Oklahoma, Pennsylvania, Rhode Island, Tennessee, Vermont, Wisconsin, and Wyoming.

nexus" statute. The project was initiated in March, 2010 and is on-going in the Commission's Uniformity Committee.

Contrary to the assertions of Plaintiff-Appellee, the Performance Marketing Association ("PMA") in the case below,[4] the test for facial discrimination under the "dormant" Commerce Clause is not whether a statute could be interpreted or applied in a manner such that some hypothetical seller could successfully argue that it was unconstitutionally subject to tax obligations. The test for facial discrimination is whether the statute by its terms provides discriminatory treatment to out-of-state interests; that is, whether the law would have a discriminatory effect on out-of-state sellers as a group in all circumstances. *United States v. Salerno*, 431 U.S. 739 (1987); *Daniels v. Area Plan Commission of Allen County*, 306 F.3d 445 (7th. Cir. 2002). Public Act 96-1544 amends 35 ILCS 105/2 by including an additional category of "retailers with a presence in the state" subject to sales and use tax collection responsibility: vendors who pay commissions to in-state residents for the vendor's sales made through the resident's website. Defining a state's taxing jurisdiction to include those who use in-state solicitors to further their sales does not facially discriminate against interstate commerce, nor does it have a discriminatory effect.

The law is well established that the presence of representatives in the state for the purpose of facilitating sales constitutes a "physical presence" sufficient to permit a state to require collection of sales and use taxes under *Quill* v. *North Dakota*, 504 U.S. 298, 314-5 (1992). In that case, the Court announced a "bright-line" physical presence test for imposition of sales and use tax collection responsibilities, but in doing so the Court re-

[4] *See PMA Cross Motion for Summary Judgment and Reply,* V.2, C. 287-96; V.4, C 767-72.

affirmed two previous cases in which it had upheld sales and use tax impositions based on the presence of independent contractors in those states, *see Scripto v. Carson,* 362 U.S. 207 (1960)(presence of independent sales representatives) and *Tyler Pipe Industries* v. *Washington State Dept. of Revenue,* 483 U.S. 232 (1987)(presence of independent technical advisor in state), because those cases "involved taxpayers who had a physical presence in the taxing State." 504 U.S. at 315. The contours of the representational nexus doctrine are not so rigid that it would exclude from taxation those engaged in solicitation of in-state customers through an in-state associate or representative using the Internet to make sales as opposed to face-to-face contact.

The Commission is also concerned by the circuit court's determination that that Public Act 96-1544 is preempted by the federal Internet Tax Freedom Act, 47 U.S.C.A. § 151 (note). The Commission contends that Illinois' law does not impose any discriminatory tax on Internet access as defined in that Act because 35 ILCS 105/2 defines "retailer with a place of business in the state" much more broadly than just vendors who enter into commission-based contracts with in-state representatives for internet solicitations; the definition of "retailers with a place of business in the state" includes *all* vendors with a physical location in the state, and also includes vendors who use targeting advertising, targeted television programming or phone solicitations. Because the statutory definition is an inclusive and not exclusive list, the classification presumably includes vendors who use *any* type of in-state representatives to solicit business on a commission basis. Public Act 96-1544 merely clarifies that Internet solicitation will not be treated any differently from other kinds of solicitation. As PMA noted in its summary judgment motion in the case below, the use of commission-based

"performance marketing" contracts is not confined to the Internet but includes commission-based print and television marketing as well. *PMA Cross Motion for Summary Judgment and Reply,* V.2, C 287-96; V. 4, C. 767-72. The preemption provisions of the ITFA are not implicated by Public Act 96-1544 because it clarifies that vendors who use Internet solicitation will be treated the same vendors who solicit through other types of media under 35 ILCS 105/2. Illinois' use tax regime does not impose any different obligations on vendors who use the Internet than it imposes on vendors who use more traditional solicitation techniques, so IFTA's preemptive provisions are not implicated here.

The Commission suggests that this court should construe the preemption provisions of ITFA narrowly, and reject any interpretation that would result in an unintended and potentially unconstitutional restriction of states' sovereign taxing authority. In addition, any interpretation of ITFA that simply preempted all states' taxation of sales accomplished through the Internet would exceed Congressional authority under the 10th Amendment to the United States Constitution. *See National Federation of Independent Businesses* v. *Sebelius,* 567 U.S. __, 132 S.Ct. 2566, 2577-8 (2012).

II. THE DECISION BELOW

On May 7, 2012, the circuit court for Cook County, Illinois, County Department—Law Division, Tax and Miscellaneous Section, issued an Order granting summary judgment to the Plaintiff, Performance Marketing Association ("PMA"), and denying the cross motion for summary judgment filed by the Defendant, Brian Hamer, acting as Director of the Illinois Department of Revenue. The circuit court found that 35 ILCS 105/2 as amended by Public Act 96-1544 violated the "substantial nexus"

requirement of the Commerce Clause of the U.S. Constitution, Article I, Section 3, rendering the "applicable provisions" of the Act "facially invalid", and therefore unenforceable. V. 5, C. 1065-67.

The circuit court also found in favor of PMA' argument that Public Act 96-1544 violated the state tax preemption provisions of the federal Internet Tax Freedom Act, 47 U.S.C.A. § 151 (note), and was thus unenforceable under the Supremacy Clause of the U.S. Constitution, Art. 6, Cl. 2. V. 5, C. 1066.

On May 11, 2012, the circuit court entered an amended order concluding that the court could not interpret Public Law 96-1544 in a manner in which it could be constitutionally applied, and stating that it was therefore necessary to reach that issue for purposes of resolving the case. V. 5, C1081-84. The circuit court did not otherwise elaborate on the basis for its determinations.

III. ARGUMENT

A. The Illinois Statute is in the National Mainstream of State Nexus Legislation.

National Bellas Hess v. Illinois, 386 U.S. 753 (1967) and *Quill Corporation v. North Dakota,* 504 U.S. 298 (1992) stand for the proposition that under the Commerce Clause, *U.S. Const.*, Art. I, Sec. 3, a state may not impose a use tax collection duty on a remote seller unless the seller has a "substantial nexus" within the state, which the Court in *Quill* said was satisfied when the seller has contacts with the state that exceed the use of the U.S. mail or common carriers to solicit and fulfill orders. A physical presence within the state satisfies the substantial nexus requirement.

Of course, a remote seller that is a corporation or other non-natural person has no physical presence of its own whatsoever. Rather, it is a legal construct created pursuant to state statute. *See* 805 ILCS 5/2.05 *et. seq*. A corporation will, however, typically enter

into contracts for the ownership physical property and the employment of labor that it will use on its behalf. When a corporation contracts for employees or ownership of physical property that it engages in a state on its behalf, then the corporation has a physical presence in that state.

The Supreme Court has also made it clear that other types of contracts for in-state representation on the corporation's behalf, in addition to those for employment or ownership of physical property, can constitute a "physical presence" in the state. These contracts include leases of physical property. They also include contracts with independent contractors. The in-state presence of individuals or entities, working on behalf of the seller, whether as employees or independent contractors, gives rise to the state's jurisdiction ("nexus") for the remote seller. *Scripto v. Carson,* 362 U.S. 207 (1960); *Tyler Pipe Industries* v. *Washington State Dept. of Revenue,* 483 U.S. 232 (1987); *Quill* at 314-5.

The identification of commissioned-based solicitors in the state who employ the Internet in carrying out their solicitation activity as creating "nexus" for a remote vendor in the 2011 amendment to 35 ILCS 105/2 is not distinguishable from the in-state independent contractor relationships discussed in *Scripto* and *Tyler Pipe, supra.* This is precisely the type of physical presence the Court held sufficient to create nexus for sales and use tax purposes in those cases. The only distinction between these in-state representatives and the in-state independent contractors in *Scripto* is the modern means – the Internet - through with the representatives operate on behalf of the seller.

The rise of the remote sales industry, whether those sales are accomplished by mail, phone, or Internet, has had a profound effect on state and local taxation, and states have

recognized the need to address it. With the recent rapid growth in Internet purchasing in particular, there has been wide-spread confusion regarding sales and use tax liability and collection requirements. Consumers incorrectly perceive they are not required to pay state or local use taxes when they make their purchases on-line, as opposed to purchasing in local stores. Remote vendors are often uncertain about their on-line collection responsibilities. And non-compliance is the natural outcome. The result is that state and local use tax revenues from on-line sales go unremitted, putting local, in-state merchants at a competitive disadvantage. The issue is a significant one. In 2001, the national combined state and local sales tax loss from new e-commerce sales was estimated to be $7 billion.[5] The estimate for Illinois's combined state and local sales tax loss in that year was $282.2 million.[6] In a comprehensive 2009 report by economists Donald Bruce, William Fox and LeAnn Luna, the annual expected state and local revenue losses from uncollected tax on e-commerce was predicted to reach $11.4 billion by 2012.[7] And that number is derived from the baseline estimate for growth in e-commerce sales. A second forecast of e-commerce growth generated an estimate of a combined state and local revenue loss of $12.65 billion dollars by 2012.[8] Using the baseline estimate, combined state and local revenue losses from uncollected tax on e-commerce sales in Illinois are estimated to be $506.8 million dollars in 2012.[9] Under the second scenario, the

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[5] Donald Bruce and William F. Fox, State and Local Sales Tax Revenue Losses From E-Commerce: Updated Estimates, *State Tax Notes,* p. 203 (October 15, 2001)
[6] *Id.,* Table 3, p. 207
[7] Donald Bruce, William F. Fox and LeAnn Luna, *State Tax Notes,* p. 537 (May 18, 2009).
[8] *Id.*
[9] *Id.,* Table 5, p. 545.

combined state and local revenue losses in Illinois for 2012 are an estimated $562.8 million.[10]

These are developments the states cannot ignore. One way states are addressing these revenue losses and perceived disparate burdens for local merchants is by promoting federal legislation, encouraged by the Supreme Court in *Quill,* at 318, which would allow state collection sales and use tax obligation against remote sellers under certain conditions. Three bills are currently being considered in Congress: S. 1452, the Main Street Fairness Act of 2011; S. 1832, the Marketplace Fairness Act, and H.R. 3179, the Marketplace Equity Act.

There is no guarantee, however, that any of these bills will be enacted. The Main Street Fairness Act has been stalled for eight successive years without a vote in either chamber. *See* H.R. 3184, S. 1736, Streamlined Sales and Use Tax Act, 108th Cong., (2003-2004). Unless and until one of these bills becomes law, states must act within the confines of the "physical presence" requirement established in *Quill.*

For the time being then, states have a responsibility to provide guidance to consumers and vendors, instructing them on sales and use tax liability and collection requirements in the context of modern business practices, the great bulk of which involve use of the Internet. One way the states have addressed this responsibility is by providing guidance to on-line sellers regarding the types of activities that, in the context of Internet sales, meet the physical presence test established in *Quill.* *See, e.g.,* N.Y. TAX LAW §1101(b)(8)(vi) (McKinney 2008), and CAL. TAX CODE §6203 (West 2012).[11] For on-line

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[10] *Id.,* Table 7, p. 547.

[11] Seven states, including Illinois, have passed similar statutes: ARK. CODE ANN. §26-52-117 (2011); CONN. GEN. STAT. §12-407(a)(12)(L); GA. CODE ANN. §48-8-2(8)(M); 35

sellers that do not meet those nexus standards, six states have passed legislation imposing notice requirements to educate consumers that if the tax isn't collected at the time of sale the consumer must still remit it directly. *See, e.g.,* COLO. REV. STAT. §39-21-112(3.5) (2010),[12] and OKLA. STAT. 68 §1406.1.[13]

Illinois is one of nine states that have enacted statutes taking the first approach: it provides guidance to remote sellers on a type of activity that constitutes an in-state physical presence sufficient to require collection of the Illinois use tax by those sellers. The Illinois statute is solidly within U.S. Supreme Court precedent, and solidly within the mainstream of the states' modern sales and use tax administration under those precedents.

B. The Illinois Statute Is Facially Constitutional.

1. The Proper Standard for Evaluating Facial Constitutionality is Whether the Statute Discriminates by its Terms, Not Whether the Statute Could be Applied in an Unconstitutional Manner.

The circuit court below held that Illinois Public Act 96-1544 impermissibly discriminated against interstate commerce. V. 5, C. 1065-67. Although the circuit court's two orders granting PMA's motion for summary judgment do not identify the basis for the court's determination, it appears the court felt that a vendor's use of in-state commissioned representatives who solicit in-state customers by directing those customers to web site links to make their purchases could never result in that vendor having a "substantial nexus" with Illinois. The Commission believes that the wrong standard was

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ILCS 105/2; N.C. GEN. STAT. 105-164.8; R.I. GEN. LAWS §44-18-15;VT. STAT. ANN., tit. 32, §9701(9)(l) (2011) (effective only after fifteen states adopt similar legislation).

[12] The Colorado statute is currently in litigation over its constitutionality under the Commerce Clause, *Direct Marketing Association v. Roxy Huber, Director of Revenue,* No. 10-CV-01546-REB-CBS, 2012 WL 1079175 (D. Colo. 3/20/12).

[13] Four other states have adopted use tax notice and reporting statutes: S.C. CODE ANN. §12-36-2691(E)(1) (2011); S.D. CODIFIED LAWS 10-63-1 (2011); Tenn. Code Ann. § 67-6-543(f)(1)(2012); VT. STAT. ANN. tit. 32 §9701(9)(1) (2011).

applied by the lower court in determining whether a statute is facially discriminatory. The standard for determining the facial validity of a statute is whether it could be constitutionally applied to any taxpayer, not whether some application of the statute would exceed constitutional restrictions as applied in a particular set of circumstances. *See United States v. Salerno*, 431 U.S. 739 (1987); *Daniels v. Area Plan Commission of Allen County*, 306 F.3d 445 (7th Cir. 2002); *but see, A Woman's Choice-East Side Women's Clinic v. Newman,* 305 F.3d 684 (7th Cir. 2002)(acknowledging that U.S. Supreme Court has not applied *Salerno* consistently in all contexts).

Public Act 96-1544 amends the definition of a "retailer with a place of business in this state" subject to use tax collection obligations to include someone who has an in-state presence in the form of an affiliate or independent contractor soliciting sales for the taxpayer. The law is by no means an extension of the constitutional jurisprudence regarding state taxing jurisdiction over out-of-state sellers; for decades, it has been understood that using an in-state representative to further the market for one's products provides sufficient connection for the state to impose sales and use tax collection obligations.

The states' ability to tax transactions occurring in interstate commerce was unequivocally established 35 years ago in *Complete Auto Transit, Inc.* v. *Brady*, 430 U.S. 274 (1977). There, the Court reviewed its prior case law and announced that state taxes would be upheld against challenges under the "dormant" Commerce Clause, Art I, Section 8, cl. 3 of the U.S. Constitution, as long as: (1) the tax was applied to an activity that had a "substantial nexus" with the taxing state; (2) the tax was "fairly apportioned;" (3) the tax did not "discriminate against interstate commerce;" and (4) the tax was "fairly

related" to the services provided by the taxing state. 430 U.S. at 279. The Court has routinely applied this four-part test to decide the constitutionality of a variety of state tax laws, including those involving sales or use taxes. It is undisputed in this case that Illinois' sales and use tax is fairly apportioned, non-discriminatory and fairly related to services and protections provided by the state.

Here, the PMA does not dispute that Illinois' statute meets the latter three parts of the test; although it frames its attack on the statute as a facial discrimination challenge, the only issue before the court is the first of the four parts, nexus. Properly stated, then, the specific issue before the court is whether under the "representational nexus" provisions of Public Act 96-1544, the use tax would be applied in all circumstances to activity that lacks a "substantial nexus" with Illinois. *United States v. Salerno*, 431 U.S. 739 (1987).

In *Brown's Furniture, Inc. v. Wagner,* 665 N.E.2d 795, 801 (Ill. 1996), *cert. den.,* 519 U.S. 866 (1996), this Court held that the party challenging the validity of a statute on constitutional grounds bears the burden of clearly establishing that invalidity. The proper standard is not whether some scenario could be imagined under which some hypothetical taxpayer would be improperly subject to tax, which is all that the taxpayer has attempted to do in the case below. The fallacy of that approach can be demonstrated by considering the scope of state statutes imposing income taxes. Virtually all state imposition statutes, including Illinois', are written in broad language that reflects the legislatures' intent to encompass all income and activity to the extent allowed by the U.S. Constitution. *See, e.g.,* Wisconsin: Wis. Stat. Ann. § 71.23(1): ("any corporations... that derive income from sources within this state or from activities that are attributable to this state; or whose

business within this state during the taxable year"); Minnesota: M.S.A. § 290.02 ("the exercise of the corporate franchise to engage in contacts with this state that produce gross income attributable to sources within this state..."); Indiana: Ind. Stat. 6-3-2-1("...the adjusted gross income derived from sources within Indiana of every corporation"); New Mexico: N.M.S.A. § 7-2-2(A)(imposing income tax on any person "...engaged in the transaction of business in, into or from this state.").

Illinois' income tax statutes similarly impose tax on: "every individual...earning or receiving income in...this state." ILCS § 201(a). One could imagine all sorts of hypothetical taxpayers whose activities would be subject to tax under such broad language who might have a valid defense to the tax imposition under the U.S. Constitution. Arguably, a non-resident individual who invested in a mutual fund receiving dividends from a corporation doing business in Illinois, or a business person passing through Midway Airport on a connecting flight, falls within the letter of the Illinois income tax statute. Even though the statutory imposition of tax could conceivably violate the Due Process Clause under those circumstances, this court would not be justified in striking down ILCS § 201(a) as facially unconstitutional. The income tax imposition statute covers a broad range of income-producing activity that *may* give the state jurisdiction to impose its tax on a non-resident. The state's taxing authorities have the responsibility of ensuring that the statute is applied in a constitutional manner. So too, if there is a cognizable basis to challenge Public Act 96-1544, it must be a challenge based on the actual application of the Act to a real vendor, not a theoretical application to a hypothetical taxpayer.

2. When Viewed under the Proper Standard, the Illinois Statute Does Not Violate the Dormant Commerce Clause.

a. The Statute Will Apply in Circumstances that Involve a Physical Presence.

To the extent a "physical presence" continues to be a requirement for state imposition of sales and use tax obligations on remote vendors under the Commerce Clause as established in *Quill v. North Dakota*, supra, [14] Public Act 96-1544 will apply in circumstances that meet that requirement. In explaining what constituted a substantial "physical presence" within the taxing state, the Court in *Quill* noted that it had previously held in *Scripto, Inc. v. Carson*, 362 U.S. 207 (1960), that the activities of independent sales representatives was sufficient to establish nexus over the seller. 504 U.S. at 306. In *Scripto,* the sales representatives used by the taxpayer had no authority to bind the taxpayer and in fact also sold products belonging to the taxpayer's competitors. *Scripto*, 362 U.S. at 622.

Scripto v. Carson was followed by *Tyler Pipe Industries, Inc. v. Washington Department of Revenue*, 483 U.S. 232 (1987), in which the Court found that a single independent contractor in the state soliciting sales on behalf of the taxpayer was sufficient to establish a taxable nexus with the state. The Court held that, "[T]he crucial factor governing nexus is whether the activities performed in this state on behalf of the taxpayer are significantly associated with the taxpayer's ability to establish and maintain a market in this state for the sales." *Id.* at 250.

In both *Scripto* and *Tyler Pipe*, the Court held that the independent status of the actors did not alter the constitutional analysis:

> As a matter of law, the Washington Supreme Court concluded that this showing of a sufficient nexus could not be defeated by the argument that the

[14] see discussion in part 3 below.

> taxpayer's representative was properly characterized as an independent contractor, instead of as an agent. We agree with this analysis. In *Scripto, Inc. v. Carson,* 362 U.S. 207 (1960), Scripto, a Georgia corporation, had no office or regular employees in Florida, but it employed wholesalers or jobbers to solicit sales of its products in Florida. We held that Florida may require these solicitors to collect a use tax from Florida customers. Although the "salesmen" were not employees of Scripto, we determined that "such a fine distinction is without constitutional significance." *Id.* at 362 U.S. 211.
>
> 483 U.S. at 250.

In the years following *Quill,* state courts have overwhelmingly held that the in-state presence of representatives to further the taxpayer's market constitutes a sufficient physical presence under the Commerce Clause to allow taxation, even if those representatives did not act as "agents" under state law. For instance, in *Scholastic Book Clubs, Inc.* v. *Commissioner of Revenue Services*, 38 A.3d 1183 (Conn. 2012), *cert. den.*, 133 S.Ct. 425 (11/9/12), the Supreme Court of Connecticut unanimously held that a mail-order company that encouraged teachers to assist in book sales to students in exchange for "points" (which could be redeemed for school supplies and benefits like classroom refrigerators) could be subject to sales and use tax collection obligations, despite having no formal contracts with the teachers or no other physical presence in the state. The court was unimpressed with the labels assigned to the relationship between teachers and Scholastic and instead focused on the nature of the relationship:

> The nature of the program necessarily places the teachers in a position in which they are functioning in much the same way as salesmen, in that they are bringing the plaintiff's products to the attention of the students and are providing them with the means to order, pay for and receive delivery of those products. Moreover, the teachers derive benefits from the program because they earn bonus points that enable them to purchase other items of value from the plaintiff's catalog. Accordingly, under the bright-line rule established in *Bellas Hess* and *Quill* and the ''practical analysis'' required by United States Supreme Court precedent, we conclude that the activities of the Connecticut schoolteachers who participate in the plaintiff's program provide the requisite

nexus under the commerce clause to justify imposition of the taxes at issue in this case.

38 A.3d at 118.

Accord, In re Scholastic Book Clubs, Inc., 920 P.2d 947 (Kan. 1996); *Scholastic Book Clubs, Inc.* v. *Board of Equalization*, 255 Cal. Rptr. 77 (Cal. Ct. App. 1989); *Scholastic Book Clubs, Inc.* v. *Reagan Farr, Commissioner of Revenue*, 373 S.E.2d 578 (Tenn. Ct. App. 2011), *cert. den., sub. nom., Scholastic Book Clubs, Inc. v. Robert*, __S.Ct. __, 2012 WL 4437903 (11/27/12). *But see, Scholastic Book Club, Inc. v. Michigan Dep't of Treasury,* 567 N.W.2d 692 (Mich. Ct. App. 1997).

Similar holdings were issued in sales and use tax cases where in-state affiliates or third parties provided marketing or post-sale support services. The case most directly on point is of course *Amazon.com LLP v. New York State Department of Taxation and Finance,* 81 A.D. 3d 183 (N.Y. 2010), in which the New York Court of Appeals held that the entering into contracts with New York residents to promote sales through Internet referrals for a commission created a "physical presence" in the state justifying imposition of use tax collection responsibility.

The application of the representational nexus principle has not been limited to internet solicitations. In *Borders Online, LLC v. State Board of Equalization,* 129 Cal. App. 4th 1179 (Cal. Ct. App. 2005), the court held that in-state services provided by a corporate affiliate that included insertion of promotional flyers in shopping bags and accepting returns from on-line purchases supported the taxpayer's on-line sales to residents, which constituted an in-state physical presence. In *Dell Marketing LLP v. Taxation and Revenue Department,* 199 P.3d 863 (N.M. App. 2009), the New Mexico Court of Appeals held that in-state warranty services provided by an independent warranty

provider helped maintain the taxpayer's market in the state, constituting a physical presence sufficient to support the state's taxing jurisdiction. *Accord, State v. Dell International, Inc.,* 922 So.2d 1257, 2004-1702 (La. Ct. App. 2006)(third-party warranty work constituted in-state physical presence); *State v. Quantex Microsystems, Inc.,* 809 So.2d 246 (La. Ct. App. 2001)(warranty services--*dicta*). In *Travelscape, LLC v. South Carolina Department of Revenue,* 705 S.E.2d 28 (S.C. 2011), the South Carolina Supreme Court held that where the taxpayer contracted with third parties to provide hotel rooms to its customers in the state, the taxpayer had the requisite physical presence in the state, since business model depended on the lease of in-state rooms. And in *Arco Building Systems, Inc. v. Chumley,* 209 S.W.3d 63 (Tenn. Ct. App. 2009), the court held that an out-of-state taxpayer that used the services of an unrelated in-state manufacturer to facilitate sales had nexus in the state under the *Scripto* analysis.

State courts have also issued decisions finding physical presence through the activities of third parties in cases that have not involved sales and use taxes. *See, e.g., Vonage America v. Seattle*, 216 P.3d 1029 (Wash. Ct. App. 2009)(city had authority to impose excise taxes where taxpayer leased phone lines through an affiliate in order to provide services; *Kmart Properties, Inc. v. Taxation and Revenue Department,* 131 P.3d 27 (2001), (N.M. Ct. App. 2001), *partially rev'd on other grounds*, 131 P.3d 22 (2005)(in-state stores promoted value of trademarks); *America Online, Inc. v. Johnson,* No. M2001-00927 (Tenn. Ct. App. 2002), 2002 WL 1751434 (suggesting that activities of third parties in the state supporting taxpayer's internet services could constitute requisite physical presence).

The Supreme Court cases of *Quill*, *Scripto* and *Tyler Pipe*, and the myriad state court decisions which have applied their representational nexus principles in similar circumstances should be enough to establish beyond question that a "physical presence" sufficient to allow sales and use tax collection obligations can be established by the in-state activities of independent parties where those independent parties further the taxpayer's exploitation of the marketplace. Illinois' Public Act 96-1544 is firmly grounded on the principles established in those cases; it simply codifies the contours of recognized constitutional doctrine as applied to taxpayers engaged in solicitation activities through third parties in the state. Systematically contracting with an independent party in a state to sell one's products constitutes a substantial physical presence in that state. The fact that some solicitation and the orders themselves may be carried out on a web site maintained by that party, as opposed to in-person sales meetings, is of no constitutional moment, any more than the distinction between "agent" and "representative" would have changed the result in *Scripto* and *Tyler Pipe*.

Under the proper facial discrimination analysis, it is necessary only to identify instances in which Public Act 96-1544 acts in a constitutional manner in describing a type of in-state activity sufficient to constitute "representational" nexus in Illinois.

One such example would be an out-of-state vendor contracting with a private school in Waukegan to place a commissioned-based click-through site on the school's web site. In order to encourage sales and commissions, the school acts as the vendor's representative in encouraging parents, faculty and students to make purchases through the site, since those purchases will result to a 5% "rebate" for the school's annual scholarship fund. The only question before this court is whether such solicitation should be viewed

differently if carried out through a web site rather than being carried out through a "take home flyer" or word of mouth as seen in the *Scholastic* cases. The Commission believes that no such distinction can be made as a constitutional matter.

b. Supreme Court Jurisprudence May No Longer Support Application of the *Pike* Balancing Test, Thus Undermining *Quill's* Undue Burden Conclusions and Its Resulting Physical Presence Requirement.

As set forth above, the Supreme Court in *Quill* concluded that state use tax collection obligations could unduly burden interstate commerce unless limited to vendors with an in-state "physical presence." The presence of "representatives" in Illinois is one well-recognized type of physical presence, and should meet the *Quill* requirement. But the court might also consider whether the Supreme Court would continue to adhere to its "physical presence" requirement, either as a practical matter or a jurisprudential one. The practicalities of the matter are that large vendors—the only vendors subject to Public Act 96-1544 because they must have made substantial sales in prior quarters using "representatives" before the Act's collection responsibilities apply—already have access to computerized databases and sales matrixes allowing them to accurately and instantaneously compute state and local sales tax obligations.[15] Query, then, whether there remains any "undue burden" with respect to these vendors that would justify a continued "physical presence" requirement.

The jurisprudential developments in Commerce Clause analysis over the twenty years since *Quill* was decided are just as profound. The source of the Supreme Court's "undue

[15] *See, e.g.* Streamlined Sales Tax Governing Board, Inc.'s *List of Certified Service Providers* offering computerized sales and use tax calculation software: http://www.streamlinedsalestax.org/index.php?page=Certified-Service-Providers.

burdens" analysis in *Quill* was *Pike v. Bruce Church, Inc.,* 397 U.S. 137 (1970). *See Quill* at 312, citing to *Kassel v. Consol. Freightways Corp. of Del.,* 450 U.S. 662 (1981); in turn citing to *Raymond Motor Transp., Inc. v. Rice,* 434 U. S. 429, 441 (1978) and *Pike v. Bruce Church, Inc.* 397 U.S. 137, 142 (1970). The Court in *Pike* created a balancing test by which the benefits and burdens of even a non-discriminatory state regulation are to be weighed: "where the statute regulates even-handedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld *unless* the burden imposed on such commerce is clearly excessive in relation to the putative local benefits." *Pike v. Bruce Church, Inc.,* 397 U.S. at 142 (emphasis added).

The *Pike* balancing test was developed in the context of challenges to state regulatory regimes and has not been applied explicitly in any state tax case. Recently, the Supreme Court has questioned the validity of applying *Pike* in the state tax context. *Dep't of Revenue of Kentucky v. Davis,* 553 U.S. 328, 353-354 (2008) (Court is not institutionally suited to perform a *Pike* analysis of the relative benefits and burdens of a state tax provision allowing an income tax deduction for interest on government bonds issued by Kentucky and its localities while taxing interest on all other government bonds.). Justice Scalia wrote that he would go further, rejecting the *Pike* balancing test "in every case." *Kentucky v. Davis,* 553 U.S. at 360. (Scalia, J., concurring in part.) The *Quill* physical presence requirement has not been explicitly reconsidered by the Court. But the Court's current unwillingness to apply the *Pike* balancing test upon which it rests obviously calls into question the continued authority for *Quill's* "undue burden" conclusions, and thus erodes the very basis for the continued existence of its "physical presence" requirement.

C. The Illinois Statute Does Not Violate the Internet Tax Freedom Act's Moratorium on Discriminatory Taxes.

The circuit court ruled that Public Act 96-1544 is preempted by the Internet Tax Freedom Act, 47 U.S.C.A. § 151 (note) ("ITFA"), but the court's ruling did not specify which section or sections of ITFA are implicated. V.5, C. 1066. There has been very little litigation over the contours of ITFA to date. The Commission is vitally concerned that in this matter of first impression by a state's highest appellate court that ITFA's preemption provisions receive an appropriate and narrow construction , as required under long-established principles of federalism, in a manner that does not impinge on state interests in a way which Congress did not intend. Certainly, the question before this court should not be whether Public Act 96-1544 was "directed to" sales activities taking place over the Internet, which appears to be the core of PMA's complaint. Nothing in the ITFA prohibits the states from passing laws concerning, clarifying or "directed to" the subject of Internet sales; the law only prohibits *discriminatory* taxes on transactions conducted over the Internet (as well as taxes on Internet service providers, which are broadly preempted). As defined in ITFA, a "discriminatory tax" means:

> (A) any tax imposed by a State or political subdivision thereof on electronic commerce that--
>
> (i) is not generally imposed and legally collectible by such State or such political subdivision on transactions involving similar property, goods, services, or information accomplished through other means;
>
> (ii) is not generally imposed and legally collectible at the same rate by such State or such political subdivision on transactions involving similar property, goods, services, or information accomplished through other means, unless the rate is lower as part of a phase-out of the tax over not more than a 5-year period;
>
> (iii) imposes an obligation to collect or pay the tax on a different person or entity than in the case of transactions involving similar property, goods, services, or information accomplished through other means.

Presumably, the circuit court did not believe that subdivisions (i) or (ii) are violated by Illinois law. The obligation to collect sales and use tax is applicable to the same kinds of "property, goods, services and information" sold in Illinois regardless of the means used to carry out those sales, and the tax rate is the same for all such taxable transactions. PMA contends, and the circuit court apparently agreed, that Public Act 96-1544 imposes collection obligations on sellers having commission-based contractual relationships with residents using Internet solicitation that would not be imposed on vendors with commission-based contractual relationships with residents who do not use the Internet to solicit sales. V.2, C.302-02; V.4, C. 774-78.

Public Act 96-1544 specifies particular conduct and relationships with affiliates that will result in a seller being considered a "retailer maintaining a place of business in this state" (henceforth referred to as a "retailer") who is obligated to collect use tax on purchases made by Illinois customers. 35 ILCS § 105/2. A law identifying certain kinds of relationships and activity which will create "retailer" status does not "discriminate" if non-Internet sellers maintaining the same kinds of relationships and activity will also be considered "retailers". The definition of "retailer maintaining a place of business in this state" is quite broad, and includes sellers with in-state advertising contracts, with or without commission-based compensation, telephone solicitation and television shopping channels. It is clear, then, that 35 ILCS § 105/2 does not impose a different collection obligation on "retailers" using "electronic commerce" for selling than other forms of selling, such as telephone solicitations or television shopping programs.

Just as significantly, the list of persons who might be considered "retailers" is *inclusive,* not exclusive. Without a fully-developed factual record, PMA's arguments as

to what activities undertaken by a seller which would or would not create "retailer" status are simply speculative. The partial listing of potential "retailers maintaining a place of business in this state" is long but worthy of review (the provision objected to by PMA is set forth in italics):

> "Retailer maintaining a place of business in this State", or any like term, means and includes any of the following retailers:
>
> 1. A retailer having or maintaining within this State, directly or by a subsidiary, an office, distribution house, sales house, warehouse or other place of business, or any agent or other representative operating within this State under the authority of the retailer or its subsidiary, irrespective of whether such place of business or agent or other representative is located here permanently or temporarily, or whether such retailer or subsidiary is licensed to do business in this State. However, the ownership of property that is located at the premises of a printer with which the retailer has contracted for printing and that consists of the final printed product, property that becomes a part of the final printed product, or copy from which the printed product is produced shall not result in the retailer being deemed to have or maintain an office, distribution house, sales house, warehouse, or other place of business within this State.
>
> *1.1. Beginning July 1, 2011, a retailer having a contract with a person located in this State under which the person, for a commission or other consideration based upon the sale of tangible personal property by the retailer, directly or indirectly refers potential customers to the retailer by a link on the person's Internet website. The provisions of this paragraph 1.1 shall apply only if the cumulative gross receipts from sales of tangible personal property by the retailer to customers who are referred to the retailer by all persons in this State under such contracts exceed $10,000 during the preceding 4 quarterly periods ending on the last day of March, June, September, and December.*
>
> 1.2. Beginning July 1, 2011, a retailer having a contract with a person located in this State under which:
>
> A. the retailer sells the same or substantially similar line of products as the person located in this State and does so using an identical or substantially similar name, trade name, or trademark as the person located in this State; and
>
> B. the retailer provides a commission or other consideration to the person located in this State based upon the sale of tangible personal property by the retailer.

The provisions of this paragraph 1.2 shall apply only if the cumulative gross receipts from sales of tangible personal property by the retailer to customers in this State under all such contracts exceed $10,000 during the preceding 4 quarterly periods ending on the last day of March, June, September, and December.

2. A retailer soliciting orders for tangible personal property by means of a telecommunication or television shopping system (which utilizes toll free numbers) which is intended by the retailer to be broadcast by cable television or other means of broadcasting, to consumers located in this State.

3. A retailer, pursuant to a contract with a broadcaster or publisher located in this State, soliciting orders for tangible personal property by means of advertising which is disseminated primarily to consumers located in this State and only secondarily to bordering jurisdictions.

4. A retailer soliciting orders for tangible personal property by mail if the solicitations are substantial and recurring and if the retailer benefits from any banking, financing, debt collection, telecommunication, or marketing activities occurring in this State or benefits from the location in this State of authorized installation, servicing, or repair facilities.

5. A retailer that is owned or controlled by the same interests that own or control any retailer engaging in business in the same or similar line of business in this State.

6. A retailer having a franchisee or licensee operating under its trade name if the franchisee or licensee is required to collect the tax under this Section.

7. A retailer, pursuant to a contract with a cable television operator located in this State, soliciting orders for tangible personal property by means of advertising which is transmitted or distributed over a cable television system in this State.

8. A retailer engaging in activities in Illinois, which activities in the state in which the retail business engaging in such activities is located would constitute maintaining a place of business in that state.

The circuit court appears to have agreed with PMA's argument that a retailer who is engaged in "performance marketing" with an in-state affiliate through print and broadcast "advertisers" would not be considered a "retailer" , while an Internet seller engaged in the identical activity would be considered a "retailer". Again, the argument is speculative at best, since the state may well conclude that *any* seller with a commission-based representative in the state is a "retailer." The 2011 amendment merely identifies several

types of in-state activity that do give rise to "retailer" status, including entering into commission-based Internet sales agreements with residents.

But in addition, PMA is comparing apples to oranges, since the particular form of solicitation activity addressed in Public Act 96-1544 is arguably unique to Internet website inter-connections ("click-throughs"). Since the activity is unique, there is no comparison class upon which to base a claim of discriminatory treatment. In contrast to what happens when a customer sees a "performance-based" advertisement in a magazine or other print media, in the case of Internet affiliate relationships a potential customer gains instant access to the "retailer's" website through the affiliate's website. The immediacy and directness of the connection between the in-state representative and the "retailer" is analogous to an out-of-state casino using a dedicated van service to bring gamers directly from a state's airport to the entrance of the casino. The in-state representative has contractually arranged to be the means of communication not just for delivering a solicitation but for the transmission of the customer from one site to another. The casino has a taxable presence based on the van's in-state pick-up and delivery. That the activity covered by Public Act 96-1544 which triggers a taxable nexus is made possible because of the Internet, does not mean that the resulting tax is discriminatory and preempted by ITFA, because there is no identical non-Internet activity which has been given preferential treatment. Thus, in *Village of Rosemont, Illinois v. Priceline.com. Inc.,* 2011 WL 4913262 (N.D. Ill. 2011), the federal district court rejected claims that ITFA barred collection of occupancy taxes on an on-line hotel reservation provider where traditional travel agents were not taxed on commissions, since travel agents operated

under different business practices. *Accord, Mayor and City of Baltimore v. Priceline.com, Inc.*, NO. CIV. A. MJG-08-3319, 2012 WL 3043062 (D. Md. 2012).

The Commission urges this court to analyze ITFA according to its terms and to reject PMA's attempt to give the preemption provisions of the statute an overly-expansive meaning. The Supreme Court has consistently recognized that the states' taxing powers provide a crucial component of sovereignty necessary to support our federal system. *See, e.g., National Private Truck Council, Inc., Oklahoma Tax Commission,* 515 U.S. 582, 586 (1995), *quoting, Dows v. City of Chicago,* 78 U.S. 108, 110 (1870)("It is upon taxation that the several States chiefly rely to obtain the means to carry on their respective governments, and it is of the utmost importance to all of them that the modes adopted to enforce the taxes levied should be interfered with as little as possible.").

This court should interpret the provisions of ITFA with the understanding that Congress knows how to write preemptory language, and does not need the assistance of the judiciary to infer that purpose if it is beyond the clear wording of the statute. *See Department of Revenue of Oregon v. ACF Industries, Inc.*, 510 U.S. 332 (1994). In *ACF Industries*, the Court refused to apply the preemption provision in the "4R Act", 49 U.S.C.A. § 11501, which preempted "any other [state] tax which discriminates," to preclude the state from taxing railroad property despite the fact that some industrial property had been granted a property tax exemption. The Court wrote that, "We will interpret a statute to pre-empt the traditional state powers only if that result is the 'clear and manifest purpose of Congress'", *quoting from, Rice v. Santa Fe Elevator Corporation*, 331 U.S. 218, 230 (1947). And as the Court wrote in *Cipollone v. Liggett Group, Inc.*, 505 U.S. 504 (1992):

> The principles of federalism and respect for state sovereignty that underlie the Court's reluctance to find preemption where Congress has not spoken directly to the issue apply with equal force where Congress has spoken, though ambiguously. In such cases, the question is not *whether* Congress intended to pre-empt state regulation, but to what extent. We do not, absent unambiguous evidence, infer a scope of preemption beyond that which clearly is mandated by Congress' language.
>
> 505 U.S. at 553 (emphasis in original); *Accord, Gregory v. Ashcroft,* 501 U.S. 452 (1991).

In the present case, as in *Rosemont, Illinois v. Priceline.com, Inc*., PMA's members have chosen a business model predicated on use of the Internet; that does not mean that Congress intended to provide them a safe harbor from state taxation; they must show actual discrimination, which they cannot do on these facts.

Under the circuit court's broad (if ill-defined) application of ITFA's preemption language, it is difficult to see how any sales carried out through the Internet would not eventually be preempted, since at least some sales carried out through other means—such as the door-to-door sale of Girl Scout cookies—will inevitably be subject to a state exemption, setting up the claim that Internet sales and solicitation have received disparate treatment. If that broad application of IFTA's preemption language were upheld as fulfilling congressional intent, it would raise the possibility that Congress had exceeded its powers under the Commerce Clause in enacting IFTA. Congress would not be "regulating commerce" in such a scenario but would instead be attempting to regulate non-discriminatory state taxing authority itself, a field of operation the framers of the Constitution chose to leave off the enumerated powers of the federal government. *See National Federation of Independent Businesses* v. *Sebelius,* 567 U.S. __, 132 S.Ct. 2566, 2577-8 (2012)(the enumerated powers granted to the federal government did not include

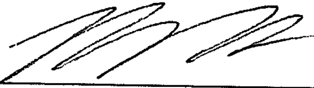
plenary power to force citizens to engage in commerce or live healthier lifestyles—such powers are left to the states.).

V. CONCLUSION

The Illinois statute is constitutional. The U.S. Supreme Court has long recognized that the in-state activities of third parties acting on behalf of out of state vendors is sufficient to give the state jurisdiction to impose a sales and use tax collection responsibility. Public Act 96-1544 relies on that constitutional precept in specifying that in-state solicitation carried out via commission-based Internet sales linkages creates nexus for the remote vendor.

The Illinois statute does not violate the Internet Tax Freedom Act. Nothing in the ITFA prohibits the states from passing laws concerning, clarifying or "directed to" the subject of Internet sales; the law only prohibits discriminatory taxes on transactions conducted over the Internet. Under Illinois law, any substantial in-state solicitation by a seller's representatives will subject that seller to sales and use tax collection obligations. In addition, to the extent the the form of "performance marketing" at issue in this case is unique, it cannot supply the basis for a claim that it has been treated less favorably than dissimilar activity. Finally, the court should presume that Congress knows how to write a preemption statute, and if the Congress wished to preempt state laws establishing nexus standards for Internet solicitation activities, it would have done so. The judgment of the circuit court should be reversed.

Respectfully Submitted,



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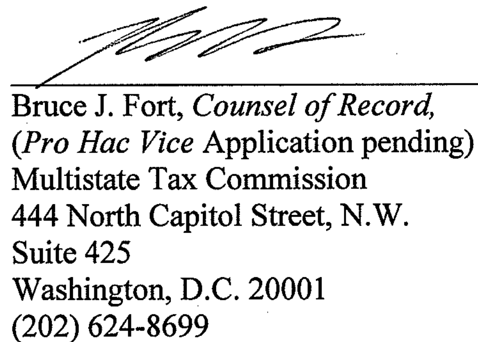
CERTIFICATE OF COMPLIANCE

I certify that this brief conforms to the requirements of Rules 341(a) and (b). The length of this brief, excluding the pages containing the Rule 341(d) cover, the Rule 341(h)(1) statement of points and authorities, the Rule 341(c) certificate of compliance, the certificate of service, and those matters to be appended to the brief under Rule 342(a) is 29 pages.



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Multistate Tax Commission

NOTICE OF FILING AND PROOF OF SERVICE

The undersigned certifies that one (1) true and correct copy of the foregoing Motion for Leave to File *Amicus Curiae* Brief and three (3) true and correct copies of the foregoing Brief of *Amicus Curiae* Multistate Tax Commission were served upon the below-named parties on December 5, 2012, by depositing a copy in the United States mail at 2 Massachusetts Ave. NE, Washington, DC 20002, in an envelope bearing sufficient postage, before 5:00 p.m.

The original Motion for Leave to File *Amicus Curiae* Brief, plus one (1) true and correct copy of the Motion for Leave to File *Amicus Curiae* Brief and one (1) true and correct copy of the Brief of *Amicus Curiae* Multistate Tax Commission were served upon the Clerk's Office in the Michael A. Bilandic Building, 160 North LaSalle Street, Chicago, IL 60601, by depositing a copy in the United States mail at 2 Massachusetts Ave. NE, Washington, DC 20002, in an envelope bearing sufficient postage, before 5:00 p.m.

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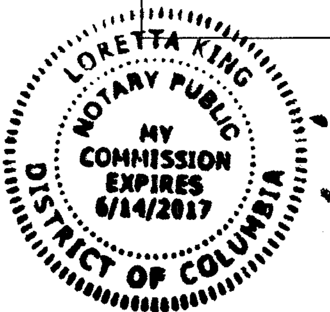
Signature: ______________________

STATE OF DISTRICT OF COLUMBIA)
)ss.
COUNTY OF N/A)

On this 5th day of DECEMBER 2012, before me, the undersigned notary public, appeared LILA DISQUE, proved to me through satisfactory evidence of identification, which were STATE ISSUED ID, to be the person who signed on the preceding or attached document in my presence.

IN TESTIMONY WHEREOF, I have hereunto set my hand and affixed my seal in said State and County on the day and year last above written.

Notary Seal



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(Signature of Notary)

My Commission Expires: June 14, 2017